

Chapter 4

Category 11a

Household Income Above Income Limit upon Initial Occupancy

Definition

This category is used to report units that have been rented to households with incomes that do not meet income eligibility restrictions. According to IRC §42(g)(1), an owner of a tax credit property must elect to serve tenant populations with gross incomes that are either 50% or less of Area Median Gross Income (AMGI) or the National Nonmetropolitan Median Gross Income (NNMGI) when applicable¹, or 60% or less of AMGI or NNMGI when applicable, as adjusted for family size.² Under the terms of an extended use agreement, an owner may agree to service tenant populations at AMGI levels lower than identified in IRC §42(g); nonperformance of such agreements is not a reportable noncompliance event.

Annual Household Gross Income is the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period *following* the effective date of the income certification. The combined income of all occupants of a unit, whether or not legally related, is compared to the appropriate percentage of the AMGI for a family with the same number of members³.

If information is available on changes expected to occur during the year, that information is used to most accurately determine the anticipated income from all known sources during the year. Unanticipated income received after the household moves in will not affect the original determination that a household is eligible for LIHC housing.

State agencies are required to review the low-income certifications, and the supporting documentation, for the tenants in a sample of LIHC units.⁴ Therefore, the state agency must review the initial income certification if the tenant moved in within the last year and the most recent income recertification for continuing tenants.

Where the owner has received a waiver of the annual income recertification requirements, the state agency will always review the initial income certification.⁵

Determining Income Limits (Area Median Gross Income)

To determine the appropriate household income limit figure, refer to the HUD-published table relating to “very low income,” which is an income level at or below 50 per cent of the Area Median Gross Income (AMGI). HUD prepares tables and provides income

¹ IRC §1400N(c)(4), Special Rule for Applying Income Tests: In the event of property placed in service (A) during 2006, 2007, or 2008, (B) in the Gulf Opportunity Zone, and (C) in a nonmetropolitan area (as defined in section 42(d)(5)(C)(iv)(IV)), section 42 shall be applied by substituting ‘national nonmetropolitan median gross income (determined under rules similar to the rules of section 142(d)(2)(B))’ for ‘area median gross income’ in subparagraphs (A) and (B) of section 42(g)(1).

² Note: Once made, this election is irrevocable and applies to all low-income units. See IRC §§42(g)(1) and 42(i)(3)(A)(ii).

³ See Rev. Rul. 90-89, 1990-2 C.B. 8.

⁴ See Treas. Reg. 1.42-5(c)(2)(ii)(A) and (B).

⁵ See Rev. Proc. 2004-38, section 5.07, 2004-2 C.B. 10.

figures for family sizes ranging from one to eight persons.

If the owner elected the 40/60 minimum set-aside, then the published income figures for the 50 per cent of AMGI should be multiplied by 1.2.⁶ There should be no rounding of these figures, as HUD has already rounded up the figures in the tables.

Households and Family Size

As a general rule, a “household” consists of all individuals (or tenants) residing in a unit. To determine the household income limit, all applicable income standards are adjusted for family size. For LIHC purposes, all occupants of a unit are considered in the determination of family size except the following (refer to HUD Handbook 4350.3 for complete discussion):⁷

1. Live-in aides. A person who resides with one or more elderly persons, near-elderly persons, or persons with disabilities, and who is determined to be essential to the care and well-being of the person(s); is not obligated for the support of the person(s); and would not be living in the unit except to provide the necessary supportive services. While a relative may be considered to be a live-in aide/attendant, they must meet the above requirements. The income of live-in aides is not included in the household’s income.
2. Foster children or foster adults
3. Guests

When determining family size for income limits, the owner must include the following individuals who are not living in the unit:

1. Children temporarily absent due to placement in a foster home;
2. Children in joint custody arrangements who are present in the household 50% or more of the time;
3. Children who are away at school but who live with the family during school recesses;
4. Unborn children of pregnant women (as self-certified by the woman);
5. Children who are in the process of being adopted;
6. Temporarily absent family members who are still considered family members. For example, the owner may consider a family member who is working in another state on assignment to be temporarily absent;

⁶ Rev. Rul. 89-24, 1989-1 C.B. 24.

⁷ IRC §142(d)(2)(B) refers to the income of individuals. The combined income of all occupants of an apartment, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the [same] number of members. See Rev. Rul. 90-89, 1990-2 C.B. 8.

7. Family members in the hospital, or a rehabilitation facility, for periods of limited or fixed duration are considered a family member. These persons are temporarily absent; and
8. Persons permanently confined to a hospital or nursing home. The family decides if such persons are included when determining family size for income limits. If the family chooses to include the permanently confined person as a member of the household, the owner must include income received by the confined person in calculating family income.

Changes in Family Size

Changes in the size of an existing household after the initial tenant income certification must also be addressed.

Family Size Increases

The addition of new member(s) to an existing low-income household requires the income certification for the new member of the household, including third party verification. The new tenant's income is added to the income disclosed on the existing household's tenant income certification.⁸ The household continues to be income-qualified, and the income of the new member is taken into consideration with the income of the existing household for purposes of the Available Unit Rule under IRC §42(g)(2)(D). See chapter 14.

Example 1: Additional Person Joins Household During the Year

Jim and his two children initially income qualified and moved into an LIHC unit on March 1, 2001. The household continued to qualify at the annual income recertification for 2002, 2003, and 2004. Jim then met Jane, and they decided to marry in October 2004. The new couple would like to live in the LIHC unit Jim occupies. Jane completes a tenant income certification.

The certification effective date continues to be March 1, 2001 and the next annual income recertification is due within 120 days before March 1, 2005.

If the household's income, when Jane's income is added, exceeds 140 percent of the income limit (170 percent in deep rent skewed projects), then the Available Unit Rule applies.

A household may continue to add members as long as at least one member of the original low-income household continues to live in the unit. Once all the original tenants have moved out of the unit, the remaining tenants must be certified as a new income-qualified household unless the remaining tenants were income qualified at the time they moved into the unit.

If a state agency determines that the tenants manipulated the income limitation

⁸ Under Treas. Reg. 1.42-5(c)(iii), owners must obtain an *annual* income certification from each low-income tenant. Interim income recertifications are not contemplated under IRC §42.

requirements, then the unit should not be treated as a low-income unit as of the date the household initially occupied the unit.

Example 2: New Tenants Manipulated Income Limitations

An income-qualified household consisting of one person moved into a two bedroom unit on March 15, 2005. A second tenant completed an initial income certification and joined the household soon thereafter. The combined income of the two tenants is above in income limit for a household with two members. The unit is out of compliance as of March 15, 2005.

Family Size Decreases

Decreases in family size do not trigger the immediate income certification of a new household. Subsequent annual income recertifications will be based on the income of the remaining members of the household. If the remaining household's income is more than 140 percent (170 percent in deep rent skewed projects) of the income limit at the time of the annual income recertification, then the Available Unit Rule is applicable.⁹

Example 1: Member of the Household Leaves

A married couple, with their two children, was initially income qualified and occupied a three bedroom unit. After four years, the oldest child, now 18 years old, moves out of the unit. It is not necessary to certify the remaining household as a new household. If the household's income exceeds the limit for a family with three members at the next income recertification, the Available Unit Rule is applicable.

Example 2: Unborn Children

A household was originally income qualified based on the inclusion of an unborn child. Four months later, the pregnancy ended in miscarriage. It is not necessary to certify the remaining household as a new tenant at the time of the miscarriage. If the income of the remaining household members exceeds the income at the next income recertification, the Available Unit Rule is applicable.

Verifying Income and Assets

Owners must verify all known income and assets that affect eligibility. However, if the total assets for a household are \$5,000 or less, the applicants may satisfy the asset requirement by signing a statement attesting to such fact.¹⁰

Acceptable methods of verifying information include third party verifications, reviews of documents submitted by the tenant (such as check stubs), and tenant certifications made under penalties of perjury.¹¹

⁹ See the legislative history for IRC §42, which notes that if the tenant's income increases to a level more than 140 percent above the otherwise applicable ceiling (*or if the tenant's family size decreases so that a lower maximum family income applies to the tenant*), that tenant is no longer counted in determining whether the project satisfies the set-aside requirement. The explanation continues, stating that there is no penalty in such cases if the Next Available Unit Rule is applied.

¹⁰ See Rev. Proc. 94-65, 1994-2 C.B. 798.

¹¹ Treas. Reg. §§ 1.42-5(b)(vii) and 1.42-5(c)(1)(iii).

Third party contacts are preferred. Owners should obtain the tenant's consent for the release of information before contacting third parties. Verification forms should be directly sent to and received from third parties. If third party contacts are by telephone or interview, the conversation should be documented in the tenant's file and include all the information that would have been included in a written verification. The owner may obtain acceptable third party written verification by facsimile, e-mail, or Internet.

Owners can accept tenant-provided documents (e.g., pay stubs, Forms W-2, bank statements, etc.) when third party contacts are impossible or delayed, or third party verifications are not needed (e.g., birth certificates or divorce decrees).¹²

There will be situations where it will be difficult to estimate income. For example, the tenant may work sporadically or seasonally. In such cases, owners are expected to make a reasonable judgment as to how to the most reliable approach to estimating what the tenant will receive in the coming year.

Determining Annual Income

Household income is defined as the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period following the effective date of the household's certification of income.¹³ Income includes, but is not limited to, earned and unearned income from all household members age 18 and older (adults), unearned income of minor children, and income from assets. Emancipated minors are treated as adults. As noted in chapter 5 of HUD Handbook 4350.3, "In all instances, owners are expected to make a reasonable judgment as to the most reliable approach to estimating what the tenant will receive during the year."¹⁴

Common sources of income are discussed below. Refer to HUD Handbook 4350.3 for additional information.

Employment Income

Employment income includes (but is not limited to) hourly wages, salaries, overtime pay, tips, bonuses, and commissions before any payroll deductions. Payments in lieu of employment income are also included; e.g., workers compensation, severance pay, unemployment and disability compensation. Income from employment of children (including foster children) is excluded.

Maximum benefits and annualized payments should not be used unless the source of funds is expected to continue throughout the certification period or for an indeterminable length of time. For example, if the third party does not indicate the length of time for which the tenant will be receiving a certain income, then the income should be annualized. In the event that the family cannot provide documentation that access to a specific source of income is for a limited and determinable time period, the benefits should be considered to be available for an indefinite time period and annualized.

¹² Third party contacts are considered impossible if an employer does not respond, third party charges a fee, or no third party is available. Generally a third party contact is considered delayed if a response will not be received within two weeks, but can be less if it is determined that the third party will not respond.

¹³ As explained in Treas. Reg. §1.42-5(b)(vii), gross income for purposes IRC §42 is not gross income for purposes of determining a federal income tax liability.

¹⁴The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(C).

Example 1: Benefits for Indefinite Time Period

John works as a telemarketer for \$9.00 an hour, 40 hours a week. He does not work overtime, has no other source of income, and is not planning to leave his job. His anticipated income is computed as:

$$(\$9.00/\text{hour}) \times (40 \text{ hours/week}) \times (52 \text{ weeks/year}) = \$18,720/\text{year}$$

Example 2: Benefits for Definite Time Period

A teacher's assistant works nine months annually and receives \$1,300 per month. During the summer recess, the teacher's assistant works for the Parks and Recreation Department for \$600 a month. The teacher's anticipated income is computed as:

$$(\$1,300 \times 9 \text{ months}) + (\$600 \times 3 \text{ months}) = \$13,500$$

If information is available on changes in income expected to occur during the year, use that information to determine the total anticipated income from all know sources during the year.¹⁵

Example 3: Anticipated Changes in Income

In May 2004, an unemployed plumber applies for LIHC housing. At that time, the plumber is receiving unemployment benefits of \$250.00 per month and will qualify for benefits for 4 more months.¹⁶ Beginning in October, the plumber will be employed at \$1,000 per month. The plumber's anticipated income is computed for the period from May to September, 2004 plus the income for October 2004 through May 2005.

$$(\$250.00 \times 5 \text{ months}) + (\$1,000 \times 7 \text{ months}) = \$8,250$$

Military employment may include (but is not limited to) base and longevity pay, proficiency pay, sea and foreign duty pay, hazardous duty pay, subsistence and housing allowances, and clothing allowances. All these are includable in income. Hostile fire pay, however, is excluded from income. *Note:* a temporarily absent individual on active military duty must be removed from the family and his or her income must not be included in the computation of household income, unless that person is the head of the family, spouse, or co-head.

Payments received under the Domestic Volunteer Service Act of 1973 are excluded from income. This includes employment through VISTA, Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, and senior companions. Payment received under Title V of the Older Americans Act (Green Thumb, Senior Aides, Older American Community Service Employment Program) is also excluded.

¹⁵ See Footnote #2.

¹⁶ The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(A)(1) refers to unemployment compensation as an example of income that *may* not last for a full 12 months.

Income from Training Programs

Compensation from state or local employment training programs or training of a family member as resident management staff is not included in income. Income from training programs not affiliated with a local government and income from the training of a family member resident to serve on the management staff are also excluded. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for a limited period as determined in advance under the program by the state or local government.

Amounts received under training programs funded by HUD are not included in income. Similarly, payments received under programs funded in whole or in part under the Workforce Investment Act (WIA – formerly the Job Training Partnership Act) are excluded from income. These are employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, and AmeriCorps. Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS) are excluded from income.

Excluded compensation includes stipends, wages, transportation or childcare payments received, or reimbursements of out-of-pocket costs and which are made solely to allow participation in a specific program. Income received as compensation for employment is excluded only if the employment is a component of a job-training program. Once training is completed, the employment income is included in the computation of annual income. Amounts received during the training period from unrelated sources (public assistance, social security payments, other employment) are not excluded from income.

Income from a Business

The net income from the operation of a business, profession, or sole proprietorship businesses is included in income. Net income is gross income less business expenses, interest on loans, and depreciation computed on a straight-line basis. Salaries paid to the applicant or other household members from the business must also be identified and included in income.

Business expenses do *not* include principal payments on loans, interest on loans for business expansion or capital improvements, or other expenses for business expansion or outlays for capital improvements.

If the net income from a business is negative, it must be counted as zero income. A negative amount cannot be used to offset other family income.

Example 1: Negative Income from Sole Proprietorship

John and Mary, a married couple, apply for LIHC housing. John operates a sole proprietorship business; the net income from the business after expenses last year was -\$3,500. Mary earns \$27,000 each year as an employee, as shown on the W-2 from her employer. The household's income is \$27,000. The \$3,500 loss generated by John's business cannot be used to offset Mary's wages.

Income from a sole proprietorship can be estimated by reviewing the individual's prior year tax returns and Schedules C. If necessary, the owner can ask the potential tenant to

provide a signed Form 8821, which will allow the owner to verify the information with the IRS.

Example 2: Using the Prior Year Tax Return

A potential LIHC tenant is self-employed and expects the business to continue indefinitely. The potential tenant submitted the tax return for the last year. The net income from the sole proprietorship was \$13,000. The \$13,000 figure can be used as income anticipated for the next 12 months.

Alternatively, the potential tenant can annualize income from self-employment for the current year business activity based on the number of full months in business. The formula is:

$$\frac{(\text{Net Income Year to Date}) \times 12 \text{ months}}{\text{Number of Months in Business during the Current Year}}$$

Example 3: Annualized Current Year Self-Employment Income

In September, a potential tenant prepared a Schedule C showing the income and expenses for the current year, from January 1 through August 31, using the tax form from the prior year. To date, the potential tenant has net income of \$24,000. The anticipated income is determined by multiplying \$24,000 by 12/8, which equals \$36,000. This is an acceptable estimate of future earnings.

Income from Rental Property, Partnerships, S-Corporations, and Royalties

Rental property may be real estate or personal property such as equipment or vehicles. The tenant may have income from enterprises doing business as partnerships or s-corporations, or receive royalties for copyrights or patents.

Assets

There is no limit on the amount of assets a household may hold and a household is not required to convert an asset to cash.

Assets include bank accounts, trusts, stocks and bonds, the surrender value of life insurance policies, and cash kept in safety deposit boxes or at home. One time, lump sum distributions are considered assets; e.g., inheritances, capital gains, victim's restitution and settlements on insurance claims. Lottery winnings paid in one lump payment are treated as assets. Lottery winnings paid in periodic payments must be counted as income. Lump sum payments of deferred periodic payments of supplemental security income and social security benefits are also considered assets.

For non-cash assets held for investment, the cash value is the net amount the household would receive if the assets were converted to cash. The cash value is the market value, or the amount another person would pay to acquire the asset, less the cost to turn the asset into cash.

Assets do not include necessary personal items such as clothes, furniture, cars, wedding rings, or vehicles specially equipped for persons with disabilities. Assets used in a business are not assets included in the computation of the tenant's income. If an asset is

held in the tenant's name, but the income generated by the asset accrues to someone who is not a member of the household and the other person is responsible for income taxes on the accrued income, then the asset is not included in the tenant's income.

Lump-sum additions to the household's assets, such as inheritances, insurance proceeds (including payments under health and accident insurance and worker's compensation), capital gains, and settlements for personal or property losses are excluded from income.

Example 1: Exhausting an Asset

A tenant receives a lump sum inheritance of \$12,000 and deposits the money in a savings account. The asset is disclosed and the income from the asset correctly accounted for at the time of the initial income certification. The tenant subsequently withdraws \$1,000 each month to pay personal living expenses. A year later, when the annual income recertification is completed, the bank account balance is zero. The monthly withdraws retain their character of an asset; i.e., they are not considered income. There is no need to include the bank account as an asset in subsequent annual income recertifications since the balance is zero.

Assets disposed of for less than fair market value within two years of the effective date of a tenant's initial certification or recertification, including assets placed in irrevocable trusts, are included in the tenant's income. Assets are considered to be disposed of for less than fair market value if the cash value of the assets disposed of exceeds the gross amount the tenant received by more than \$1,000. Do not include assets disposed of for less than fair market value as the result of a foreclosure, bankruptcy, or divorce or separation agreement if the applicant or tenant receives valuable consideration not measurable in dollars.

Assets must be verified, the income generated from assets must be determined, and the income included in the computation of the household's income.

1. If the total cash value of a household's assets is more than \$5,000, imputed income must be calculated using the current HUD passbook rate¹⁷ and the greater of the actual income or imputed income must be included in the household's income. Refer to the HUD Handbook 4350.3, paragraph 5-7F, for the current passbook rate.
2. If the total cash value of the household's assets is \$5,000 or less, the actual income the tenant receives from assets is the amount included in annual income as income from assets. An owner may satisfy asset verification requirements by *annually* obtaining a signed, sworn statement from the tenant certifying that the tenant's net family assets are \$5,000 or less and disclosing the tenant's annual income from net assets. Owners, however, may not rely on a low-income tenant's signed, sworn statement of income from assets if a reasonable person¹⁸ in the owner's position would conclude that the

¹⁷ Projects receiving a tax credit allocation for rehabilitation of USDA Rural Development properties typically use the USDA Rural Development passbook rate if imputed interest must be included in the income computation.

¹⁸ The "reasonable person" concept is part of the definition of due diligence. Due diligence is defined (*Black's Law Dictionary* [6th ed. 1990]) as: "Such measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances; not measured by any absolute standard, but

tenant's income is higher than the amount presented by the tenant. In such cases, the owner must obtain other documentation of the low-income tenant's annual income from assets to satisfy documentation requirements.¹⁹

**Contract Sales
of Real Estate
Assets**

A tenant may sell real estate using an installment contract (or similar agreement) that provides a stream of payments over a period of time. A portion of the payment will be applied to the principal and a portion will be interest income. The interest should be included in income; the outstanding principal is considered an asset.

**Pensions and
Trusts**

No Return of Capital

The full amount of periodic payments from Social Security, pensions and annuities, Supplemental Security Income (SSI), insurance policies, death benefits, long-term care insurance (in excess of \$180 a day) and disability payments should be included in income, including lump sum amounts or prospective monthly amounts for the delayed start of a periodic amount.

Periodic amounts from *supplemental* security income and social security benefits that are received in a lump sum amount or in prospective monthly amounts are excluded; e.g., Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, and payments to the widow of a serviceman killed in actions.

Return of Capital

Individual Retirement Accounts (IRAs), 401K's and Keogh plans are considered assets. The amount that the tenant can withdraw from a pension plan without retiring or terminating employment, less any penalties but not after tax, is considered an asset. Note: Distributions from an IRA, 401k, or Keogh are *not* periodic payments and are not counted as income as long as the individual can provide documentation that the distribution(s) are a return of capital; i.e., a return of funds the tenant paid into the retirement account.

Trust Amount

The tenant may be the recipient of earning from a trust amount, in which case the gross amount of the trust should be considered an asset. Actual income distributed from the earnings of the trust (that are not revocable by, or under the control of, any member of the tenant household) is included in income. Include only the actual income distributed.

Documentation

Benefit letters or annual statements prepared by third parties are sufficient documentation. Verification may also include bank statements noting the transfers of funds.

depending upon the relative facts of the special case." In short, the due diligence standard is a judicially created test to determine the adequacy of the efforts exerted throughout all phases of any activity.

¹⁹ See Rev. Proc. 94-65, 1994-2 C.B. 798.

Public Assistance

Amounts specified for shelter and utilities should be separately stated. They may be excluded from income. Special computations are needed; consult the HUD Handbook 4350.3 for details. Payments, rebates or credits received under the Federal Low-Income Home Energy Assistance Programs are excluded from income. Also exclude any winter differentials given to the elderly.

Special calculations of public assistance income are required for as-paid state, county or local public assistance programs. Consult the HUD Handbook for detailed instructions.

Recurring Gifts, Grants, Scholarships and Contributions

Regular, recurring monetary and nonmonetary gifts or contributions to residents from persons not living in the unit must be included in income. This can include the payments of bills on behalf of a resident. For example, if a parent or family member will be paying a resident's utility bill each month directly to the utility company, those payments are still counted as income for the tenant. However, the value of groceries provided by someone outside the household, and the food portion of public assistance, even if provided routinely, is *not* included.

Example 1: Use of Vehicle

A tenant uses her ex-husband's car to transport their son to medical examinations conducted on a regular basis. The title to the car is in the ex-husband's name, he makes the car payment, and he is responsible for maintenance.

The use of the car should not be considered a regular non-cash contribution to the household unless the tenant has exclusive use of the vehicle.

Grants received specifically for medical expenses, set aside for use under a Plan to Attain Self Sufficiency (PASS) and excluded for purposes of Supplemental Social Security (SSI) eligibility, or for out-of pocket expenses for participation in publicly assisted programs (expenses include the costs for special equipment, clothing, transportation, child care, etc.) are excluded.

For any student under the age of 24 who is seeking housing without his or her parent, financial assistance in excess of amounts received for tuition under the Higher Education Act of 1965²⁰, from private sources, or from an institution of higher education²¹ shall be considered income to that individual, except for persons over the age of 23 with dependent children. Financial assistance does not include loan proceeds for the purpose of determining income.²²

For any student residing with his or her parents, scholarships, grants, fellowships, educational entitlement, or any other student financial assistance paid directly to a full-time student or directly to an institution, no matter how the assistance is used, is excluded from income. Amounts of scholarships funded under title IC of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs are also excluded.

²⁰ See 20 U.S.C. 10001 *et seq.*

²¹ See 20 U.S.C. 1002.

²² Page 18146, Federal Register Vol. 71.

Generally, contributions that are paid directly to a childcare provider by persons not living in the unit are not included in income. This exclusion is based on a handbook interpretation of reimbursed childcare expenses under the definition of Adjusted Income and its bearing on Annual Income. See 24 CFR Parts 813.1, 215.1, and 236.1. In relevant part, the regulations define childcare expenses to include “amounts to be paid by the family for [child care]...to the extent [they are] not reimbursed.” Handbook 4350.3 indicates that childcare expenses that are not reimbursed are not included as annual income. However, if such childcare is paid by a *non-custodial* parent in lieu of all, or part, of child support payments, then it should be included in income.

**Temporary,
Nonrecurring, or
Sporadic
Income**

Irregular, nonrecurring monetary gifts or contribution to resident are not included in income.

**Alimony or Child
Support**

Alimony or child support that is court ordered or supported by a written agreement should be included in income unless the recipient certifies that the funds were not received and reasonable efforts have been made to collect the amount due, including filing with courts or agencies responsible for enforcing payments. When no documentation of child support, or alimony stipulated in a divorce decree or separation is available, the owner may require the family to sign a certification stating the amount received. The certification must be notarized. Documentation of the collection efforts made may be requested.

A signed, sworn self-certification by a tenant is sufficient documentation under Treas. Reg. 1.42-5(b)(1)(vii) to show that a tenant is not receiving child support payments and is consistent with the documentation requirements in Rev. Proc. 94-65.²³ In addition to specifying that a tenant is not receiving any child support payments, an annual signed, sworn self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant possesses a child support agreement, but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation; i.e., a divorce decree or court documents. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.²⁴

A state agency monitoring procedure, however, may not permit an owner to rely on a low-income tenant's signed, sworn statement indicating that the tenant is not receiving child support payments if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's annual child support payments to satisfy the documentation requirement in Treas. Reg. 1.42-5(b)(1)(viii).

A state agency's monitoring procedure may require that an owner obtain documentation, other than the statement described above, to support a low-income tenant's annual certification of child support payments.

²³ The signed, sworn self certification under Rev. Proc. 94-65 is equivalent to the notarized certification under HUD Handbook 4350.3, Chapter 5, paragraph 5-6E. See also paragraph 5-13D.

²⁴ See Rev. Rul. 2004-82, Q&A #12, 2004-2 C.B. 350.

**Unearned
Income of Minor
Children**

Any unearned income of children under the age of 18 is included in income. This is any income other than employment income; e.g., interest income from bank accounts or dividends from mutual funds held in their name. Unearned income of minor children should be included even if the child is temporarily absent.

**Items Excluded
from Income
(Miscellaneous)**

This section includes a description of miscellaneous sources of funds and how they should be treated for purposes of determining the household's income. Refer to HUD Handbook 4350.3, Chapter 5, and Exhibit 5-1 for additional information.

1. Lunches and food received through food programs such as Women, Infants and Children (WIC), amounts received under the School Lunch Act, Meals on Wheels, or food stamps are not included in income.
2. Amounts paid to a family to offset the costs of services or equipment needed to keep a developmentally disabled family member at home are excluded. By Federal statute, the value of food stamps is not included in income.
3. Amounts received by the household that are specifically for, or in reimbursement of, the cost of medical expenses for any member of the household are not included in income.
4. Earnings in excess of \$480 for each dependent, full-time student 18 years or older living with his or her parents is excluded from income.
5. Adoption assistance payments in excess of \$480 per adopted child are not included in income.
6. Payments received for the care of foster children or foster adults are not included in income.
7. Personal loans, since they must be repaid, are not included in income.
8. Amounts received by the household in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit are not included in income.
9. Resident service stipends are not included in income. A resident service stipend is a modest amount (not to exceed \$200 per month) received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the LIHC housing. Such services include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident initiatives coordination. No resident may receive more than one such stipend during the same period of time.
10. Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era are not included in income. Examples include payments by the German or Japanese governments for atrocities committed during the Nazi era.
11. Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602) is

not included in income.

12. Income from assets, and amounts received on behalf of, someone who does not reside in the household are not included in income, as long as (1) the amounts are not intermingled with the household's funds and (2) the amounts are used solely to benefit the person who does not reside within the household. For such amounts to be excluded from income, the individual must provide the owner with an affidavit stating that the amounts are received on behalf of someone who does not reside with the family and that the amounts meet the conditions stated above.
13. Interests of individual Native Americans in trust or restricted lands, and the first \$2,000 per year of income received by individual Native American that is derived from a trust or restricted lands are not included in income. Amounts received under the Maine Indian Claims Settlement Act of 1980 are also excluded. In addition, all or a portion of the payments under the Alaska Native Claims Settlement Act, judgments of the Indian Claims Commission or U.S Court of Claims may be excluded from income. See HUD Handbook 4350.3 for details.
14. Payments received after January 1, 1989 from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the Agent Orange product liability litigation are not included in income. M.D.L. No 236 (E.D.N.Y)
15. Any Earned Income Tax Credit to the extent it exceeds the tenant's income tax liability is not included in income. See IRC §32(j). For example, a tenant may have a tax liability of \$400, and an Earned Income Credit of \$700. The credit will not only eliminate that \$400 tax liability, but the tenant will receive a \$300 refund. The \$300 is not included in income. Alternatively, the tenant may receive payments directly from his/her employer during the year. These periodic payments are not included in income.
16. The value of any childcare provided or arranged for under the Child Care and Development Block Grant Act of 1990 (CCDBG) (42 U.S.C. 9858q) is not included in income. Participating families may either pay a reduced amount based on a sliding fee scale or they may receive a certificate for child care services. Note that funds received through CCDBG for providing childcare services are included in income.

Tenant Income Certification Effective Date

Once all sources of income and assets have been properly verified, owners or managers perform an income calculation using the applicant's tenant income certification to determine whether the applicant qualifies for IRC §42 housing.

The effective date of the tenant's income certification is the date the tenant actually moves into the unit. All adult members of the household should sign the certification. HUD Handbook 4350.3, 5-17B. If the certification is more than 120 days old, the tenant must provide a new certification.. The income recertifications must be completed annually based on the anniversary of the effective date.

Example 1: Determining the Tenant Income Certification Effective Date

A potential household consisting of John and Jane Doe and their two children completed a rental application and income certification on April 12, 2004. The property manager completed the third party verifications and determined that the household was income eligible on April 21, 2004. John and Jane signed the rental lease on April 25th, and took possession of the unit on May 1, 2004.

The effective date of the tenant income certification is May 1, 2004. All subsequent tenant income recertifications must be performed within 120 days before May 1st of each subsequent year of the 15-year compliance period.

When additional adult individuals join the household, the effective day will remain the same until the unit is completely vacated.

Example 2: Effective Date After Move In of Additional Adult Member

Jane and her daughter were income qualified and moved into an LIHC unit on September 5, 2003. On March 15, 2004, Jane's widowed mother joined the household.

The tenant income certification continues to be based on the original certification date. All subsequent annual income recertifications will be completed within 120 days before September 5th each year until the household vacates the unit.

Signatures

Generally, all adult members of the household should sign the income certification before, or when, the household moves into the rental unit. However, there will be circumstances where obtaining the signatures is impractical. In these situations, the owner should document the reason for the delay in the tenant's file and secure the signature as soon as possible.

Example 1: Household Member is Serving in the Military

Mary, with her two children, applies for an LIHC unit and completes a tenant income certification. She discloses and includes the income her husband earns for military service in the Marines. He is currently on active duty and stationed overseas. The owner determines that Mary's household is income qualified for low-income housing

Mary signs the income certification two days before moving in. Because her husband is not available to sign the certification, the owner included documentation in the tenant file that he is in the military and stationed overseas. Mary's husband returns stateside five months later and signs the income certification as soon as he joins his family.

The owner is in compliance. The household's income is properly accounted for and the file sufficiently documents the reason why the husband could not timely sign the income certification. In this case, the file will also indicate that the signature was obtained within a reasonable time after his return.

Tenant Moves to Another Low-Income Unit

A household may move to another unit within a low-income project.

In the Same Building

When a household moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit.²⁵ Thus, if a current household, whose income exceeds the applicable income limitation moves from an over-income unit to a vacant unit in the same building, the newly occupied unit is treated as an over-income unit. The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

In a Different Building

As noted in Rev. Rul. 2004-82, Q&A #8, a similar rule applies when a household whose income is no greater than 140% of the income limit (or 170% for deep rent skewed projects) moves to a low-income unit in a different building within the project during any year of the 15-year credit period.²⁶ The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

Example 1: Household is First Occupant of Low-Income Unit

On May 31, 2004, of the first year of the credit period, an income qualified household moved into a new, never-occupied, low-income unit in Building A. On October 19, 2004, the household moved to a similar rent-restricted unit in Building B, which had never been occupied, and continued to occupy the unit until the end of the first credit year. The unit in Building A was not rented again until February 2005.

Only the unit the household actually occupies qualifies as a low-income unit.

- The unit in Building A would qualify for May, June, July, August and September. The unit would not qualify as a low-income unit in October, November, or December for purposes of computing the Applicable Fraction for the first year under IRC §42(f)(2). The unit will continue to be treated as a never occupied unit until a qualified household moves in.
- The unit in Building B is a qualified low-income unit for October, November, and December.

²⁵ See Treas. Reg. 1.42-15(d).

²⁶ See IRC §42(g)(1) and IRC §142(d)(4)(B).

Income Certifications Where Owner Acquires or Rehabilitates Existing Building

Income Qualifying Households Before the Beginning of the 10-Year Credit Period

Under Rev. Proc. 2003-82, a unit occupied before the beginning of the credit period will be considered a low-income unit at the beginning of the credit period, even if the household's income exceeds the income limit at the beginning of the first year of the credit period, if two conditions related to income qualifications are met, and the unit must be rent restricted.²⁷

For households occupying a unit at the time of acquisition²⁸ by the owner, the initial tenant income certification is completed within 120 days after the date of acquisition using the income limits in effect on the day of acquisition. The effective date of the tenant income certification is the date of acquisition since there is no move-in date.

In the event that the household occupies a unit at the time of acquisition, but the tenant income certification is completed more than 120 after the date of acquisition, the household is treated as a new move-in. Owners use the income limits in effect at the time of the tenant income certification and the effective date is the date the last adult member of the household signed the certification (this is an exception to the general rule for effective dates because there is no move-in date).

When the household moves into a unit after the building is acquired but before the beginning of the first year of the compliance period, the tenant income certification is completed using the income limits in effect at the time of the certification and the effective date is the date the household moves into the unit.

Testing for Purposes of the Next Available Unit Rule

For purposes of Rev. Proc. 2003-82, the incomes of the individuals occupying a unit occupied before the beginning to the first credit year are first tested for purposes of the Next Available Unit Rule under IRC §42(g)(2)(D)(ii) and Treas. Reg. 1.42-15 at the beginning of the first year of the building's credit period.²⁹

1. The test must be completed within 120 days before the beginning of the first year of the credit period.
2. The "test" consists of confirming with the household that sources and amounts of anticipated income included on the tenant income certification are still current. If additional sources or amounts of income are identified, the tenant income certification will be updated based on the household's documentation. It is not necessary to complete third party verifications.
3. If the household is over-income based on current income limits, the Next Available Unit Rule is applied.

²⁷ Rev. Proc. 2003-82, 2003-2 C.B. 1097, provides a safe harbor under which, if certain conditions are met, a residential rental unit in an existing building acquired by a new owner or in rehabilitated building will be treated as a low-income unit even though the occupants' incomes exceed the income limit at the beginning of the building's 10-year credit period. In order to qualify, the household must have been income-qualified at the time the owner acquired the building or the date the household started occupying the unit, whichever is later. The owner must maintain documentation of the income qualification and the unit must be rent restricted. See chapter 10 for further discussion of the requirement for units to be rent-restricted.

²⁸ The date of acquisition is the date the building is acquired by purchase under IRC §179(d)(2).

²⁹ See chapter 14 for detailed discussion of the Next Available Unit Rule.

If the effective date of the initial tenant income certification is 120 days or less before the required “test”, it is not necessary to “test” for purposes of the Next Available Unit Rule because the time period for completing the initial tenant income certification and the time period for completing the “test” is the same. The annual tenant income recertification will be completed each year on the anniversary of the original tenant income certification’s effective date.

Example 1: The Effective Date of Initial Tenant Income Certification is 120 Days or Less Before the Test Date

An owner purchased an existing building on September 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A occupied a unit at the time of the purchase and was determined to be income qualified on September 22, 2004. Because the household was determined to be income-qualified within 120 days of January 1, 2005, it is not necessary to “test” for purposes of the Next Available Unit Rule.

If the effective date of the original tenant income certification is more than 120 days before the required “test,” the household’s income must be tested within 120 days before the beginning of the first year of the credit period.

Example 2: The Effective Date of Original Tenant Income Certification is More Than 120 Days Before the Beginning of the First Year of the Credit Period

An owner purchased an existing building on March 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A, an income qualified household, moved into a rent-restricted unit on April 1, 2004. Because the household was determined to be income-qualified more than 120 days before the beginning of the credit period on January 1, 2005, the household’s income must be tested no earlier than 120 days before January 1, 2005 to determine whether the Next Applicable Unit Rule should be applied.

Income Qualifying Households During the First Year of the 10-Year Credit Period

Under IRC §42(f)(2), the applicable fraction for the first year of the credit period is computed based on a month-by-month accounting of units or floor space occupied by income-qualified households. In the case of buildings that were acquired and then rehabilitated, there are two separate allocations of credit documented on two Forms 8609; one for the acquisition credit and a separate allocation for the rehabilitation credit. However, the owner is not required to determine two applicable fractions. Under IRC §42(e)(4)(B), the applicable fraction for the substantial rehabilitation credit will be the same as the applicable fraction for the acquisition credit. Therefore, for purposes of computing the applicable fraction under IRC §42(f)(2), the following units are considered low-income units;

1. Units occupied before the beginning of the credit period, which are determined to be low-income unit at the beginning of the credit period under Rev. Proc. 2003-82.
2. Units initially occupied after the beginning of the credit period by newly certified income-qualified households (regardless of whether rehabilitation costs have been incurred for the unit).

3. Units occupied by income-qualified households that moved from other units within the project. The household's lease and tenant income certification (with effective date) move with the household. See the section above titled "Tenant Moves to Another Low-Income Unit" for complete discussion.
4. Vacant units that are suitable for occupancy under IRC §42(i)(3)(B)(ii) and were previously occupied by an income-qualified household, regardless of whether rehabilitation costs have been incurred for the unit during the first year of the credit period.

Units are *not* included in the numerator of computation of the applicable fraction if:

1. The unit is occupied by a nonqualified household;
2. The unit is vacant and was last occupied by a nonqualified household;
3. The unit is not suitable for occupancy under IRC §42(i)(3)(B)(ii). These units, including units being rehabilitated, are considered "out of compliance." The noncompliance is corrected when the unit is again suitable for occupancy. The unit's character will be determined based on the household that occupied the unit immediately preceding the rehabilitation during the first year of the credit period. See #4 on the list above.

Example 1: Units Rehabilitated During the First Year of the Credit Period

An owner acquired a building with 10 units and determined that 6 of the units (1-6) were occupied by nonqualifying households at the beginning of the first year of the credit period, on January 1, 2005. Four units (7-10) were occupied by income-qualified households. The nonqualifying households moved out and the owner rehabilitated the six vacant units. Five of the rehabilitated units (1-5) were rented to new households that moved into the units in August of 2005. The sixth rehabilitated unit (6) was rented in August to an existing tenant who transferred from unit 7, one of the four units qualifying on January 1, 2005

1. The owner may include units 1-5, the rehabilitated units occupied by new low-income tenants in the applicable fraction computation under IRC 42(f)(2) for August, September, October, November, and December of 2005
2. For the tenant who transferred between units within the building, the owner may include the unrehabilitated unit 7 that the tenant occupied from January through July in the computation of the applicable fractions for those months, but the unit is no longer a low-income unit when the household moves to the rehabilitated unit 6 in August; Unit 6 is a low-income unit for August through December.

Therefore, for purposes of computing the applicable fraction for August, 2005, there are three low-income units that have not been rehabilitated (units 8, 9, and 10) and six low-income units that have been rehabilitated (units 1-6). Unit 7 is not a low-income unit.

During September, unit 7 was rehabilitated and the tenant from unit 8 moved in; therefore, unit 8 is no longer a low-income unit. To expedite completion of the rehabilitation of the remaining units, the owner also temporarily located the households in 9 and 10 in off-site quarters (and paid all expenses) and started rehabilitation of units 8, 9, and 10. For purposes of determining the applicable fraction for September, units 1-7 are low-income units and units 8, 9, and 10 are out of compliance.

The owner completed the rehabilitation of the final three units (8, 9, and 10) in October and moved the two temporarily displaced households back into units 9 and 10 during October 2005. Unit 8 is a low-income unit because it was previously occupied by an income-qualified household. For purposes of computing the applicable fraction for October, units 1-10 are all low-income units.

The following chart summarized the status of each unit for each month during 2005.

| Unit | Jan | Feb | Mar | Apr | May | June | July | Aug | Sept | Oct | Nov | Dec |
|------|------|------|------|------|------|------|------|------|------|------|------|------|
| 1 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 2 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 3 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 4 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 5 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 6 | | | | | | | | LIHC | LIHC | LIHC | LIHC | LIHC |
| 7 | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | | LIHC | LIHC | LIHC | LIHC |
| 8 | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | | LIHC | LIHC | LIHC |
| 9 | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | | LIHC | LIHC | LIHC |
| 10 | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | LIHC | | LIHC | LIHC | LIHC |

Documentation Requirements

For a unit to be included as a low-income unit, documentation of the household's initial eligibility must be on file with the owner. Under IRC §6001, every taxpayer is required to maintain records sufficiently detailed to prepare a proper tax return. This requires the maintenance of such permanent books and records sufficient to establish the amounts of gross income, deductions, *credits*, or other matters to be shown on the taxpayer's return. This requirement extends to the preparation and maintenance of tenant files sufficiently documented to support household eligibility for purposes of claiming the low-income housing credit under IRC §42.

A tenant income certification and supporting documentation are not sufficient unless, at a minimum, the following documents are included:

1. Application/Income and Asset Questionnaire - A document completed by the household that the owner uses to gather information relevant to establishing all aspects of eligibility including, but not limited to, household composition, income, income from assets, and student status.
2. Verification of Income and Assets - All sources of income and assets must be verified to establish move-in eligibility.³⁰ Each tenant file must contain an annual statement of income, household composition, and student status.

The preferred verification method is through third parties, and such verifications must be no older than 120 days before the effective date of the Tenant Income Certification. Where applicable, there should be further evidence to support the third party verifications; e.g., a copy of a divorce decree showing award of maintenance or child support, a realtor's statement of market value for a home, a self-employed tenant's tax return, etc. When third party verification has been attempted, but is not possible, documentation may be by check stubs, W-2's, bank statements, etc. Self-certification may be accepted if third party verification or other documentation cannot be obtained. Documentation of attempts to obtain verification, however, must be kept on file.

3. Student Status - Depending upon the student status of each household member, student verification may be required. (See chapter 17 for more information.)
4. Tenant Income Certification – Documents must be signed by all the adult members of a household prior to move-in and at the time of the annual recertification, and must state the anticipated annual gross income of the household.

**Sufficient But
Imperfect
Documentation**

If eligibility documentation is imperfect, yet sufficient for the monitoring agency to make a reasonable determination that a household is eligible, the owner should be advised of the imperfections and the need to implement procedures ensuring that similar imperfections do not occur in the future. Imperfections are not of a nature that would cause the unit to be considered out of compliance and will not result in reportable noncompliance.

**Use of
Standardized
Forms**

The compliance monitoring regulations under Treas. Reg. §1.42-5 establish the minimum monitoring requirements. State agencies can determine how documents are maintained and may mandate the use of standardized forms to document an owner's compliance with the requirements under Treas. Reg. §1.42-5.

³⁰ Rev. Proc. 94-65, 1994-2 C.B. 798, allows building managers to obtain a tenant's signed, sworn statement if the total combined cash value of household assets is less than \$5,000. Some states have not implemented this procedure and will require third party verification. The states that allow this have an appropriate form.

In Compliance

In order to establish a unit as a qualified housing tax credit unit, the household's Gross Annual Household Income must be at or below the elected area median income (AMGI) limit or national nonmetropolitan median gross income (NNMGI) limit when applicable, adjusted for family size. Household income is calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937. Therefore, the definitions of income of individuals and AMGI for purposes of IRC §42(g)(1) include items of income that are not included in a taxpayer's gross income for purposes of computing a federal tax liability.

Documentation of the household's initial eligibility must be on file with the owner. The initial tenant income certification must be completed and signed by all the tenants on or before the move-in date.

Example 1: Unrelated Parties Sharing an Apartment

Sally and Jane are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Sally and Jane's combined income does not exceed 60% of the AMGI for a two-individual family.

In this case, Sally and Jane are qualified tenants for low-income credit housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

State agencies may determine that, even though the documentation at the time a certification was performed was insufficient, sufficient documentation was subsequently obtained by the owner *before* the state agency's notification of a compliance review, which allowed the monitoring agency to make a reasonable determination that the unit was in compliance. Such self-corrected documentation should not be reported to the IRS as noncompliance. The owner has demonstrated due diligence and reasonable attempts to maintain sufficient documentation of tenant eligibility.

Example 2: Failure to Obtain Third Party Verification

An owner initially failed to verify or include documentation of court-ordered child support when the household moved in. The oversight was identified nine months later when the owner's management company conducted a quality review of the file. The management company immediately corrected the deficiency by obtaining a copy of the court order for the child support. When the amount of child support was added to the move-in income, the annual income did not exceed move-in eligibility. The unit is in compliance with IRC §42 requirements.

Example 3: Correction After Notification of Upcoming Compliance Review

Unit A in an LIHC building went out of compliance on January 15, 2004, when a household with income exceeding the limit moved in. The owner was notified on March 15, 2004, that the state agency would be conducting a

tenant file review on May 1, 2004. The owner realized the problem while preparing for the review and paid the moving costs for the over-income household to move out immediately. A new income-qualified household moved into Unit A on April 13, 2004.

The state agency selected Unit A as part of the 20% sample and reviewed the new tenant's income certification. Because the effective date of this certification was after the date of the notification of the upcoming review, the state agency requested the file for the previous tenant and determined that Unit A was out of compliance from January 15 to April 13, 2004.

Example 4: Tenant Income Increases After Move In

John and Mary are newly married, in their early 20's, and have moved to a new city where John has accepted a job. The couple is income-qualified based on John's anticipated salary for the next 12 months. Three weeks after they move in, Mary starts working. If her wages are added to the tenant income certification, the couple's income exceeds the limit.

There is no noncompliance if the state agency determines that the owner used due diligence in accepting John and Mary as a qualified low-income household based on their initial tenant income certification. For example, the owner can demonstrate that due diligence was exercised by asking whether Mary intended to seek employment. However, the next available unit rule may apply. See chapter 14.

By itself, the fact that a tenant's actual income exceeds the anticipated income identified during the income certification is not a reportable noncompliance event (hindsight is always perfect). However, the state agency should consider expanding the sample size if multiple instances are identified. Collectively, multiple errors are indicative of poor internal control and increased risk of noncompliance.

The tenant income certification should be based on the best information available at the time of the certification. It represents the income the household anticipates it will receive in the 12-month period *following* the effective date of certification of income. If information is available on changes expected to occur during the year, that information should be used to most accurately determine the anticipated income from all known sources during the year. Owners should use due diligence by asking follow-up questions when the income certification process reveals unusual circumstances suggesting additional sources of income.

Out of Compliance

Units are considered out of compliance as of the date an ineligible household moves into a unit. A unit will also be considered out of compliance if the initial tenant income certification is inaccurate, documentation of initial eligibility is insufficient, or no initial tenant file is on record.³¹

³¹ A determination by the IRS (during an examination) that the taxpayer has not maintained adequate books and records may result in the issuance of an Inadequate Records Notice. The notice informs taxpayers that their recordkeeping practices are insufficient and must be improved to meet the requirements of the law. The issuance of an Inadequate Records Notice may result in a follow-up examination.

Example 1: Specific Source of Income Omitted

Annual Income was not properly calculated. The manager/owner did not include a source of income, such as a raise, overtime, or bonus. When reviewed, a correct calculation indicates that the household was not income eligible at move-in.

Example 2: Household Incorrectly Determined to be Eligible

The owner calculated annual household income correctly, but the household is over the appropriate income limit at move-in. For example, the owner may have used the income limit for the 40/60 minimum set-aside when the income limit for the 20/50 minimum set-aside income limit was required, or the wrong county AMGI, or the income limits used were not in effect as of the date of the tenant income certification.

Example 3: Unrelated Parties Sharing an Apartment

Tom and Jack are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Tom and Jack individually have incomes that do not exceed 60% of AMGI for one individual. However, Tom's and Jack's combined income exceeds 60% of the AMGI for a two-individual family.

In this case, Tom and Jack do not qualify for LIHC housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

Example 4: No Initial Tenant Income Certification on File

A household moves into a unit that the owner wishes to include as an LIHC unit. However, the owner does not provide documentation of initial eligibility at the time the state agency reviews the tenant's file. The owner cannot substantiate that the unit qualifies for the LIHC.

Example 5: No Initial Tenant Income Certification on File for New Member of Household

An income qualified household moved into an LIHC unit. Six month later, an adult friend moved into the unit with the household, but no initial tenant income certification was completed for the additional member of the household.

**Example 6: Initial Tenant Income Certification Performed After Move-In
(Late Certification)**

A household moved into a unit that the owner wanted to include as a low-income unit. However, the certification of income eligibility, including the third party verification, was not performed until after the household moved in.

Example 7: Insufficient Documentation of Initial Eligibility

A household moves into a unit that the owner wishes to include as a low-income unit. Income eligibility was not properly documented. The state agency could not reasonably determine that the household was income qualified. The following are possible documentation noncompliance issues:

- a. Application/questionnaire is not sufficiently detailed to disclose all sources of income and/or assets,
- b. Not all sources of income are verified,
- c. Not all sources of assets are verified,
- d. Verifications are insufficient,
- e. Not all adult household members' income and/or assets are disclosed and included;
- f. Tenant income certification form is not prepared, signed and/or dated; and
- g. Other state-required forms designed to document compliance with IRC §42 are not in file.

Back in Compliance

Units are back in compliance when it is determined that an income-qualified household occupies the unit. Evidence of corrected noncompliance includes copies of certification paperwork such as the tenant's application, income and asset questionnaire, third party verifications, and tenant income certification.

**Insufficient
Documentation**

In the event that income eligibility was not properly documented and the state agency cannot reasonably determine that the household is eligible, the noncompliance can be corrected in either of two ways:

1. A new certification can be performed using current income and asset sources and current income limits. Assuming the household is eligible, the unit would be out of compliance on the date of move in and back in compliance on the date the new certification signed (Form 8823 should be filed); or
2. A retroactive certification can be performed which completely and clearly documents the sources of income and assets that were in place at the time the *initial certification* should have been effective, and applies income limits that were in effect on that date. Assuming the owner can document that the household was income eligible at the time of move in, the unit should not be considered out of compliance. The owner has clarified the noncompliance; Form 8823 should not be filed.

Evidence of corrected noncompliance may include a copy of the full certification, including application, third party verifications, and/or the tenant income certification.

**Income
Ineligible
Households**

The household may be income certified as if it were a new move-in. If the household is eligible under the applicable move-in income limit in place on the date of the new certification, then the unit would be considered back in compliance.

Example 1: Ineligible Household Occupies LIHC Unit

The household was over the appropriate income limit at move-in on June 1, 2002. The error was discovered during the state agency's review on April 3, 2003.

The owner may treat the household as a new tenant and complete a new income certification using the income limits in effect on April 3, 2003. If the household is qualified, the noncompliance is corrected. The unit is out of compliance from June 1, 2002 until April 3, 2003. If, upon certification, the household is not income-eligible, the unit is considered back in compliance when a new income-qualified household moves into the unit. In either scenario, a Form 8823 noting the noncompliance must be filed.

**Initial Tenant
Income
Certification is
Late**

If the initial certification is late, the unit is considered out of compliance as of the date the tenant moved into the LIHC unit and back in compliance on the date the completed income certification, indicating the household is income qualified, is signed by all the tenants.

**Example 1: Initial Tenant Income Certification Performed After Move-In
(Late Certification)**

A household moved into an LIHC unit on August 4, 2003. However, certification of eligibility, including the third party verification, was not completed until September 15, 2004. If the tenant income certification meets all the requirements, the unit is considered in compliance beginning on September 15, 2004.

Note: Noncompliance with the initial income certification requirements that is identified and corrected by the owner retroactive to move-in and *prior to notification* of the compliance review by the state agency need not be reported; i.e., the owner has demonstrated due diligence by addressing noncompliance issues independently. See chapter 3.

**Revoking a
Waiver of the
Annual Income
Recertification
Requirement**

If noncompliance with the tenant income certification requirements is sufficiently serious for a building with a waiver of the annual income recertification requirements, consideration should be given to revoking the waiver.³² Revocation is not required, but the Service will revoke the waiver at the state agency's request.

Instructions for requesting the revocation of a annual income recertification waiver are included with the instructions for completing Form 8877, Request for Waiver of Annual Income Recertification Requirement for the Low-Income Housing Credit.

³² See Rev. Proc. 2004-38, which supersedes Rev. Proc. 94-64.

References

1. IRC § 42(g)(1)
2. Treas. Reg. 1.42-5(b)(1)(vii) states that “[t]enant income is calculated in a manner consistent with the determination of annual income under Section 8 of the U.S. Housing Act of 1937.”
3. HUD Handbook 4350.3 is the authority for further information on calculation of annual income. HUD publishes updated 50% Median Family Income limits annually. Other income limit schedules such as the 60% limits are based on an extrapolation of the 50% limits. HUD’s Summary of Questions on Handbook 4350.3 Rev-1 was also used as a resource.
4. Rev. Rul. 89-24, 1989-1 C.B. 24
5. Rev. Rul. 90-89, 1990-2 C.B. 8
6. Rev. Rul. 91-38, 1991-2 C.B. 3
7. Rev. Rul. 2004-82, 2004-2 C.B. 350
8. Rev. Proc. 94-65, 1994-2 CB 798
9. Rev. Proc. 2004-38, 2004-2 C.B. 10, which supersedes Rev. Proc. 94-64, 1994-2 C.B. 797
10. Rev. Proc 2003-82, 2003-2 C.B. 1097
11. Notice 88-80, 1988-2 C.B. 396